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Millennium Challenge Compact with Mozambique

A. INTRODUCTION

Since emerging in 1992 from three decades of nearly continuous conflict, Mozambique has experienced one of the fastest growth rates in Africa, averaging eight percent per year over the last decade. To sustain this growth, it is necessary to unlock the potential of the economically lagging Northern provinces, which are home to approximately 10 million people. Moreover, given Mozambique's rapid urbanization, its next stage of economic recovery cannot succeed without well-functioning public services in its cities, where coverage levels for water and sanitation, for example, are declining.

B. PROGRAM

1. Goal and Objectives

The \$506.9 million Compact focuses on water, sanitation, roads, land tenure, and agriculture (*the "Program"*), as summarized in the table below. The Program involves crucially needed investments in physical assets, policy reforms, capacity building, and institutional strengthening.

Program	CIF/Year 1	Year 2	Year 3	Year 4	Year 5	Total
1. Water Supply & Sanitation Project	16,250,586	33,486,540	60,354,509	51,577,477	41,916,281	203,585,393
2. Roads Project	5,430,562	4,420,542	39,733,884	79,578,499	47,143,993	176,307,480
3. Land Tenure Services Project	5,261,274	12,369,941	9,541,389	6,823,931	5,071,772	39,068,307
4. Farmer Income Support Project	3,754,417	3,491,632	3,851,878	3,375,446	2,958,838	17,432,211
5. Monitoring and Evaluation	2,195,000	955,000	1,880,000	920,000	2,255,000	8,205,000
6. Program Administration & Oversight	23,577,473	11,014,974	10,086,885	9,009,757	8,636,572	62,325,661
Total MCC Contribution	56,469,312	65,738,629	125,448,545	151,285,110	107,982,456	506,924,053

The Program's goal is to reduce poverty in Northern Mozambique through economic growth. The Program's objective is to increase the productive capacity of the population in selected districts, with the intended impact of reducing the poverty rate, increasing household income and employment, and reducing chronic malnutrition in the targeted districts. The various interventions are designed to foster investment and increase economic opportunities for Mozambicans living in the North.

2. Program Rationale

The Program addresses key constraints to growth in Mozambique, which include:

- An inadequate stock of infrastructure – particularly for roads, water, and sanitation – that has degraded because of years of war and lack of maintenance;
- An poor investment climate, including land tenure administration;

- Limited human capacity and poor health; and
- Low levels of productivity affecting agriculture.

The Program is consistent with two key themes of the Government of Mozambique's ("**GOM**") development strategy: (a) decentralization and urban-based growth; and (b) meeting the Millennium Development Goals for water and sanitation. It also is consistent with and a key part of the United States Government's ("**USG**") foreign policy and public diplomacy objectives.

C. PROGRAM DESCRIPTION

1. Water and Sanitation Project (\$203.6 million)

Lack of access to water and sanitation is a major barrier to growth and health. Mozambique has one of the lowest levels of per-capita water consumption in the world. With an average of less than 10 liters per day, the country is far below global benchmarks. Moreover, due to existing gender norms, girls and women are responsible for collecting most of the water at the household level. They spend hours fetching water, leaving little time for child care, attending school, or income-generating activities.

The Water Supply and Sanitation Project will improve access to safe, reliable water supply and sanitation services, thereby increasing productivity and reducing water-borne diseases -- one of the causes of death in children under five. It involves: (a) water supply and sanitation services in three large cities (Quelimane, Nampula, and Pemba) and three mid-sized towns (Gurué, Mocuba, and Nacala) in the provinces of Zambézia, Nampula and Cabo Delgado; (b) water supply services in two small towns (Monapo and Montepuez) and 600 rural villages in the provinces of Nampula and Cabo Delgado; (c) capacity building of local institutions; and policy development.

MCC's capital investments in water and sanitation will build on the pioneering work begun in the mid-1990s and funded by the World Bank to put in place the key sectoral institutions and regulatory frameworks. MCC funding will also address some key heretofore neglected market segments -- small-town water supply and sanitation -- and, in so doing, will help consolidate and advance the GOM's water sector strategy. In urban water supply, the strategy is based on a separation of asset ownership and operations and maintenance ("**O&M**"). Under the so-called system of delegated management, the state owns the water assets; O&M is carried out by the private sector; and an independent regulatory authority ("**CRA**") sets service standards and regulates tariffs. Accordingly, the MCC program is predicated on private sector participation to reduce operating costs and improve service -- factors that are key to sustainability.

2. Roads Project (\$176.3 million)

The objective of the Roads Project is to: (a) improve access to markets, resources, and services; (b) reduce transport costs for the private sector to facilitate investment and commercial traffic; (c) expand connectivity across the Northern region and down toward the southern half of the country; and (d) increase public transport access for individuals to take advantage of job and other economic opportunities. Specifically, MCC funding will rehabilitate 491 km of key segments of the National Route 1, which forms the backbone of country's transportation network, in three provinces. The road

segments will include Rio Lurio – Metoro in Cabo Delgado (74 km); Namialo - Rio Lurio (148 km) and Nampula – Rio Ligonha (102 km) in Nampula; and Nicoadala – Chimuara (167 km) in Zambézia.

These roads are part of the GOM's five-year master plan for roads, known as the Integrated Road Sector Program (PRISE), a sector-wide initiative for developing the national road network. The PRISE's first three-year rolling investment program (covering 2007-2009) is budgeted at more than US\$1 billion, and includes: (i) the building, rehabilitation, and maintenance of roads and bridges; (ii) the development of pilot projects to test low-cost materials; and (iii) the implementation of a road-safety initiative.

MCC funding will support the following types of interventions:

- Design, environmental assessment, and construction activities;
- Implementation of environmental and social mitigation measures, including compensation for physical and economic displacement of individuals and businesses affected by the rehabilitation and construction;
- Design, construction and rehabilitation of drainage and bridge structures;
- Posting of signage and incorporation of other safety improvements;
- Project management, supervision, and auditing; and
- Technical assistance and capacity building.

3. Land Tenure Services Project (\$39.1 million)

The objective of the Land Tenure Services Project (“**Land Project**”) is to establish more efficient and secure access to land by improving the policy and regulatory framework and helping beneficiaries meet their immediate needs for registered land rights and better access to land for investment. The Land Project – which would operate in all four provinces, but could have a national impact – is comprised of three mutually reinforcing activity areas: (a) a **Policy Support Pillar** to help improve the policy environment by addressing implementation problems in the existing land law and regulatory reviews to improve upon it; (b) a **Capacity Building Pillar** to build the institutional capacity to implement policies and provide quality public land-related services; and (c) a **Site-specific Pillar** to facilitate access to land use by helping people and business with: (i) clear information on land rights and access; (ii) more predictable and speedy resolution of land and commercial disputes, thereby creating better conditions for investment and business development; and (iii) registering their grants of land use.

4. Farmer Income Support Project (\$17.4 million)

Coconuts and coconut products form an important part of the economy in Northern Mozambique. However, outbreaks of Coconut Lethal Yellowing Disease (“**CLYD**”) now threaten the industry and the livelihood of over 1.7 million people in the provinces of Zambézia and Nampula. At the present rate of spread, more than 50 percent of the coconut area is likely to be lost over the next nine years. Affected trees cease producing and threaten the productivity of healthy trees; therefore they must be removed and replaced.

The objective of the Farmer Income Support Project is to improve productivity of coconut products, and encourage diversification into other cash-crop production. The Project will eliminate biological and technical barriers hindering economic growth among farms and targeted enterprises, while supporting diversification into other cash crops and improved farming practices to assist smallholders and producers to recover lost income. In conjunction with tree removal and replacement, the Project will assist farmers in adopting new cropping systems and developing alternative sources of cash income during the time required for new coconut trees to reach productive age, i.e., seven years and beyond. The Project will also provide technical support to introduce better practices aimed at increasing crop yields.

D. IMPACTS

Four strategic elements coalesce to form a platform to achieve the overall Program objectives:

- Increase the accessibility, reliability, and quality of water and sanitation facilities;
- Increase access to productive resources and markets;
- Make land access more efficient and secure for households, smallholders, and investors; and
- Improve productivity of coconut products and diversify into other cash crops.

The four strategic objectives, if achieved, will result in increased investment and employment. Overall, the Program will increase regional gross domestic product across the targeted provinces in Northern Mozambique – Cabo Delgado, Nampula, Zambézia, and Niassa – by nearly \$75 million in 2015 and \$180 million in 2025. A projected 33 percent of the population of these provinces would have been poor in 2015 without the Program. The Program can be expected to reduce the projected poverty rate by over 7 percent by 2015 and by over 16 percent by 2025. As a result of Program implementation, nearly 270,000 persons will be lifted out of poverty by 2015 and 440,000 persons by 2025. The net present value of the net economic benefits of the Program comes to more than \$420 million discounted at the MCC hurdle rate for Mozambique.

At the project level, the **Water Supply and Sanitation Project** is expected to assist some 1.9 million beneficiaries by 2015 through improved water systems, wastewater disposal, and storm water drainage. Around one-third of these beneficiaries are among the poor. The net present value of the net economic benefits for all of the water and sanitation activities (for large cities and towns, small towns, and rural stand posts) amounts to close to \$360 million discounted at the MCC hurdle rate for Mozambique.

By 2015, nearly 2.3 million people – of whom more than one-third is likely to be poor – will benefit from the **Roads Project**, by having improved access to markets and services. The net present value of the net economic benefits for all of the roads activities amounts to more than \$20 million discounted at the MCC hurdle rate for Mozambique.

The **Land Project** will assist anyone who has or acquires land-use rights. Improved land tenure services are projected to benefit 1.9 million people by 2015, the first year after the end of the Compact, and to benefit 2.6 million people, 15 years after the end of the Compact. The net present

value of the net economic benefits for the Land Project amounts to more than \$4 million discounted at the MCC hurdle rate for Mozambique.

The **Farmer Income Support Project** will benefit 1.7 million smallholders as well as workers on coconut estates, which employ some 5,000 workers. Half of these smallholders would be in poverty even without income losses from CLYD. The net present value of the net economic benefits for the Farmer Income Support Project amounts to \$38 million discounted at the MCC hurdle rate for Mozambique.

E. PROGRAM MANAGEMENT

1. Governance Structure

The implementation and management arrangements are designed to ensure strong governance, oversight, management, monitoring and evaluation (“**M&E**”), and fiscal accountability in the use of MCC funds. The GOM will create MCA-Mozambique as a public institution to oversee and manage the program as an autonomous accountable entity. MCA-Mozambique will have: (1) a Board of Directors to oversee implementation, make strategic decisions, and ensure the execution of agreed policy reforms; (2) an Executive Committee, composed of a smaller working group of Board members or their representatives, to facilitate implementation by assisting in decisions regarding technical matters; and (3) a Management Unit to handle the day-to-day operations. The Board will be composed of representatives from government, private sector, and civil society. It will also include as non-voting members, a representative from MCC, a representative of an environmental NGO, and the Executive Director of MCA-Mozambique. The Management Unit will be composed of professional staff hired through an open and competitive recruitment. MCA-Mozambique will have an office in Maputo and a field office in Nampula.

Stakeholder participation will occur at both the Program and Project levels. At the Program level, stakeholders will be able to provide feedback through participatory M&E fora. Mechanisms will also be structured at the Project-level to allow the private sector, civil society, and local/regional governments to provide advice and input for implementation.

2. Implementation Arrangements

Line ministries and public institutions will serve as Implementing Entities (“**IEs**”) and service providers for the various projects. IEs will be responsible for developing the operational requirements for the Projects and performance monitoring of contractors. Teams will be located within the IEs to ensure institutional strengthening and close collaboration and communication. To help ensure Program success, the Compact has budgeted nearly \$40 million for technical assistance, capacity building, and institutional strengthening. In addition, competitively selected external service providers will perform the Procurement and Fiscal Agent functions.

F. OTHER HIGHLIGHTS

1. Transformational Change

The Program has the potential for significant transformational change to help unlock the economic potential of the northern part of the country by addressing key binding constraints to growth. Overall, the Program is expected to reach a total of five million people, many of whom will benefit from multiple Projects. In addition, the Program will have an important qualitative developmental impact, by helping to develop and consolidate key sectoral institutions and improve water and sanitation services, road maintenance, and land tenure.

2. Consultative Process

The Compact is derived from Mozambique's Poverty Reduction Strategy Paper, known as PARPA in Portuguese, which was submitted to a domestic consultation involving a wide variety of sectors and an extensive range of stakeholder groups, including the poor. For the MCC program, the GOM conducted a consultative process through two organizations: the Poverty Observatory, an umbrella group of non-governmental organizations ("*NGOs*"), and the Federation of Economic Associations (the "*CTA*"), a private sector trade association. The Poverty Observatory and CTA together represent the preponderance of NGOs, not-for-profit, and domestic for-profit businesses in Mozambique.

3. Government Commitment and Effectiveness

The GOM has demonstrated commitment by showing a willingness and flexibility to develop solutions for inefficient government procedures that affect implementation of donor-funded programs. It also has already initiated institutional reform and organizational restructuring processes in the water and sanitation and roads sectors and in land. The GOM is working with MCC and the World Bank to carry out the necessary policy reforms for program success, building on the crucial institutional developments identified by the GOM as part of the Compact development work funded by an MCC 609(g) grant. Over the past two years, the GOM has developed a new road strategy and investment program that includes an organizational restructuring of the road agency and performance-based disbursements linked to measurable indicators for routine maintenance, among others. To supplement this, MCC also successfully negotiated a commitment by the GOM to implement a rigorous periodic maintenance program covering the country's entire paved road network, upon which disbursement of MCC funding is contingent. In December 2006, the GOM passed a decree approving urban land regulations, which establish the rules governing the use and enjoyment of land in towns and cities.

G. SUSTAINABILITY

1. Water and Sanitation

For urban water, the Water and Sanitation Project will help promote the sector's evolution and solidify its institutions, while addressing the institutional capacity gap for smaller cities and towns and for sanitation. The sustainability of the water supply projects in the three large cities (Nampula, Quelimane, and Pemba) is assured through the existing state-owned asset-holding company for water

(“**FIPAG**”), which operates on a self-sustaining basis. The proposed investments will help consolidate the financial sustainability of FIPAG by providing additional assets and water sales volume without adding additional debt. The GOM is establishing a FIPAG-like entity, the Asset Management Unit (“**AMU**”), as part of the National Water Directorate, with the assistance of World Bank funding to improve service delivery in the smaller cities and towns (Nacala, Gurué, Mocuba, Monapo, and Montepuez). The AMU – along with the expansion of the scope of the independent regulatory authority – will provide the basis for cost-based tariffs to ensure commercially sustainable operations and maintenance services. For the largest cities, CRA will continue to set tariffs to ensure full cost recovery. In smaller towns and in rural areas, as well as for sanitation, tariffs will be set to recover, at a minimum, 100 percent of O&M costs. This is projected to occur by 2015, after a period of tariff adjustments.

2. Roads

The Roads Project’s sustainability depends upon the functioning of the two major institutions in the sector – the National Road Agency (“**ANE**”) and the Road Fund. ANE is undergoing reorganization in order to provide more efficient maintenance and system management. On the financial side, responsibility for revenue collection, identifying sources of funding, and financial management is the purview of the Road Fund, which is under the Ministry of Finance. The Road Fund is capitalized by a fuel levy, which enables the roads sector to meet its routine maintenance requirements. Nevertheless, to help ensure asset preservation, MCC obtained a government commitment from the GOM during Compact negotiations to fully fund and execute periodic maintenance, which should occur on a seven-year cycle for paved roads. As a condition precedent to disbursements for civil works, the GOM will present – to MCC’s satisfaction – a rigorous plan for periodic maintenance covering the entire paved road network. Under this plan, the near-term periodic maintenance funding will come from user fees, GOM funds, and donor funds. Over a 10-year period, however, the plan would phase out donor-funded periodic maintenance and replace it with user fees.

3. Land

The Land Project addresses sustainability by supporting the development of an overall strategy for modernization of land services that emphasizes client service, adoption of technology solutions adapted to the local context, and strengthening of financial and human resource capacity. Re-establishing trust and creating efficiency in public land services will increase citizen and business use of services, thereby contributing to high-quality, up-to-date records. The GOM’s increased ability to collect land rents from leases of public land and expanded collection of rationalized service fees will provide a major improvement in capacity to fund public land services at the national, provincial, and municipal levels. Finally, the Project will enable significant progress to improving access to and security of land tenure, which will help facilitate sustainable economic development through increased investment.

4. Farmer Income Support Project

Sustainability for the Farmer Income Support Project is linked to the overall market performance of coconuts and alternate crops. The market for coconuts and its processed products is growing domestically and internationally, as are markets for targeted alternate crops. Yield improvements

should help foster sustainability, as should the adoption by smallholders of improved farming practices and crop diversification, which can help reduce their risks and vulnerability. The Project would also promote environmental sustainability, as coconut trees are particularly productive at carbon sequestration.

5. Environment and Social Impacts

MCC requires that all Projects comply with national laws and regulations, MCC's Environmental Guidelines and Gender Policy, and World Bank Operational Procedure 4.12 on Involuntary Resettlement (WB OP 4.12). None of the Projects is likely to generate significant adverse environmental, health, or safety impacts. However, several of the Water and Sanitation Project ("Category A," according to MCC's Environmental Guidelines) activities have the potential for limited resettlement, alteration of river flows and aquatic habitat, and over-extraction of surface and/or groundwater resources that may require mitigation. Since the Roads Project ("Category B") involves the rehabilitation and paving of existing roads and not the construction of new roads, any negative environmental or social impacts are expected to be mitigatable. Similarly, any potential negative environmental and social impacts of the Land Project ("Category C") and the Farmer Income Support Project ("Category B") are expected to be mitigatable. The full scope of the impacts of each Project will be further examined through various environmental and social assessments that the GOM will conduct during the first year of implementation. Any negative impacts or risks identified through these assessments would be mitigated or managed through adequate approaches to implementation, including preparing and implementing environmental management plans, resettlement action plans, and gender analyses, as necessary.

It is important to note that a number of positive environmental and social benefits should emerge from many of the Compact activities, most notably from the Water and Sanitation and the Farmer Income Support Projects. Furthermore, to maximize the positive social impacts of the Compact and ensure compliance with MCC's Gender Policy, the GOM will develop: (a) a Gender Integration Plan that includes approaches for meaningful and inclusive consultations with women and vulnerable and under-represented groups; and (b) Project-specific gender analyses, the results of which will be incorporated into final Project designs.

To promote environmental and social sustainability, MCA-Mozambique will ensure that comprehensive public consultations are developed so that Project stakeholders, including women and vulnerable groups, are afforded consultation and an opportunity to provide their inputs to Project design and implementation. MCA-Mozambique will ensure that environmental and social mitigation measures are followed for all Project activities in accordance with the provisions set forth in the Compact and supplemental agreements.

H. DONOR COORDINATION

MCC has worked closely with various multilateral, bilateral, and private donors to facilitate Program design. MCC has not only built off existing successful programs, but has also catalyzed financial support from several donors. In **water and sanitation**, MCC coordinated closely with the water sector working group of donors throughout all stages of Compact development. For **land tenure**, MCC coordinated closely with many donors, including most extensively with USAID, DFID, and the

World Bank. The Land Project is designed to build on prior schemes and to complement existing initiatives. Specifically, it will support a “buy-in” to a multi-donor program called the Land Fund to allow its expansion into three more provinces. MCC funds will add greater emphasis on women’s land rights. Finally, the Compact will support municipal cadastre work, and will draw lessons from the experience gained under USAID’s local governance project, which is piloting cadastre work in five municipalities currently. In *roads*, MCC resources, like all major donor and GOM investments going into the sector, will fund road improvements in the context of the GOM’s five-year master plan, called the Integrated Road Sector Program (“*PRISE*”). MCC’s participation in the PRISE would be in the form of project finance, while other donors will use a mixture of both project finance and pooled funding.

MCC has also taken a proactive approach to coordinating with various USG agencies throughout the Compact development and due diligence process, including: USAID, State Department, USTR, USTDA, Africa Development Foundation, Treasury Department, Department of Commerce, Department of Justice, USDA Forest Service, OPIC, US Export-Import Bank, and the HELP Commission.

I. THE “MCC EFFECT” IN MOZAMBIQUE

The “MCC Effect” has been pronounced in Mozambique in several different ways, including: (1) creating space to increase the voice of civil society in developing the original proposal; (2) mobilizing other donor activity; and (3) catalyzing the implementation of an urban water and sanitation strategy for small towns.

In the water/sanitation sector, the prospect of a large MCC investment led the World Bank to assemble a package of up to \$40 million in funding to complement MCC’s interventions and invest in areas beyond MCC’s scope. This package will help leverage the impact of MCC’s investments, and is estimated to reach approximately two million beneficiaries at the national level. Combined with MCC investments in water/sanitation, which will reach more than 1.9 million people, nearly four million people in total will benefit from improved water and sanitation services.

In addition, through the 609(g)-funded Compact development process, MCC has already succeeded in pushing to develop further Mozambique’s land policy and to make it more effective in practice. This was not easy given the post-war legacy of extreme sensitivity around land issues. As a result, other donors are contemplating ramping up their own initiatives to support interventions on land policy and to engage the government on needed policy and institutional reform.